

In re Smith, Bankr. Case No. 92-14324 (Bankr. E. D. Tenn.
Jan. 13, 1995)

The debtors have objected to claim 17 and the amendment (claim 17a) filed by the IRS (the Internal Revenue Service). The debtors argue that the claim should be disallowed because it was filed after the last day for filing proofs of claims.

The rules of bankruptcy procedure set deadlines for filing a proof of claim in a chapter 13 case. FED. R. BANKR. P. 3002(c), 3004 & 3005. The law requires notice to creditors of the bankruptcy case and the last day to file a proof of claim. 11 U.S.C. § 342; FED. R. BANKR. P. 2002(f)(3).

The court may allow a late-filed claim as timely filed if the creditor did not receive notice in time to file a proof of claim before the deadline. *United States v. Cardinal Mine Supply, Inc.*, 916 F.2d 1087 (6th Cir. 1990); *IRS v. Century Boat Co. (In re Century Boat Co.)*, 986 F.2d 154, 23 Bankr.Ct.Dec. 1700 (6th Cir. 1993); *In re Cole*, 146 B.R. 837 (D. Colo. 1992); *In re Anderson*, 159 B.R. 830 (Bkrtcy. N.D. Ill. 1993).

The IRS does not argue that lack of notice prevented it from filing the proof of claim or asking for an extension before the deadline. FED. R. BANKR. P. 3002(c)(1). The IRS admits receiving the notice in October 1992. The notice included notice that the last day to file claims was February 2, 1993. The IRS did not file the proof of claim until a year later.

Excusable neglect is a ground for allowing a late-filed claim as timely filed in a chapter 11 case, but apparently not in a chapter 13 case. FED. R. BANKR. P. 9006(b)(1) & (b)(3); *Pioneer Investment Services Co. v. Brunswick Associates Ltd. Partnership*,

113 S.Ct. 1489, note 4 at 1495, 123 L.Ed.2d 74 (1993).

The IRS argues that late filing simply is not a ground for disallowing the claim. The IRS relies on the *Hausladen* case and other decisions that have followed it. *In re Hausladen*, 146 B.R. 557, 27 Collier Bankr.Cas.2d 1321 (Bankr. D. Minn. 1992); *In re Gullatt*, 164 B.R. 279 (Bankr. M. D. Tenn. 1994), *rev'd Gullatt v. United States (In re Gullatt)*, No. 3:94-0229, 1994 WL 371077 (M. D. Tenn. Jul. 7, 1994)(Wiseman, D.J.); *In re Babbitt*, 164 B.R. 157 (Bankr. D. Colo. 1994); *In re Sullins*, 161 B.R. 957 (Bankr. M. D. Tenn. 1993).

Section 501 of the Bankruptcy Code provides that a creditor may file a proof of claim. It also allows the debtor, a co-debtor, or the bankruptcy trustee to file a proof of claim for a creditor. 11 U.S.C. § 501.

Section 502(a) says that a claim is deemed allowed if proof of the claim is filed under § 501 and no party in interest objects. "Deemed allowed" means that the claim is allowed without a court order if no party in interest objects. 11 U.S.C. § 502(a);

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The first question is whether § 502(a) allows a party in interest to object on the ground that the proof of claim was filed late or in some other way does not comply with the requirements set out in the bankruptcy rules.

The counterargument says that § 502(a) only makes a distinction between filing and not filing a proof of claim. If a proof of claim is not filed, then the claim is not deemed allowed.

If a proof of claim is filed, then the claim is deemed allowed, and it makes no difference whether the proof of claim meets all the requirements set by the rules. Of course, this amounts to saying that failure to meet a requirement set by the rules is not by itself a ground for objecting to a claim. The party who objects must show that failure to meet the requirement set by the rules prevents the proof of claim from being "proof of the claim" under § 501.

The court does not agree. If this argument were correct, the bankruptcy courts would be required to decide on a case-by-case basis what it takes to make a valid proof of claim. Each court would be creating rules, or re-creating the rules that already exist, as to what constitutes a valid proof of a claim. Section 501 clearly contemplated and in effect authorized the adoption of time limits for proving claims. 11 U.S.C. §501. The court thinks that it also authorized the adoption of other requirements for a proof of claim.

The court concludes that § 502(a) allows an objection to a claim on the ground that the proof of claim was not filed in accordance with the rules.¹ For a claim to be deemed allowed, §502(a) requires filing a proof of claim, and if an interested party objects, filing in accordance with the bankruptcy rules.²

The next question is whether the court can disallow a

¹This kind of objection is an attempt to rebut the presumption in FED. R. BANKR. P. 3001(f).

²Since most of the rule requirements are evidentiary, this kind of objection may lead to a ruling on the merits that the claim is not enforceable under non-bankruptcy law. 11 U.S.C. §502(b)(1).

claim for failure to file before the deadline assuming someone has objected. Under the court's interpretation of § 502(a), the claim would no longer be deemed allowed. There is an argument that disallowance is not the correct terminology. Rather than being disallowed, the claim is simply unallowed. The basic effect is the same. The claim is not entitled to payment from the money of the bankruptcy estate that is available to pay unsecured claims.

The court does not mean to say that failure to follow the rules will always result in disallowance of the claim. A creditor may cure an objection by amending the proof of claim. And failure to comply with the rules may be excused in some situations. *Unioil v. Elledge (In re Unioil, Inc.)*, 962 F.2d 988 (10th Cir. 1992) (amendment to correct defective proof of claim); 8 LAWRENCE P. KING, ET AL., COLLIER ON BANKRUPTCY ¶ 3003.03[3] (15th ed. 1994) (informal proofs of claims).

A creditor who files after the deadline obviously cannot cure the problem. The creditor may try to prove inadequate notice as a ground for treating the claim as timely filed. If that fails, the late filing appears to prevent the claim from being allowed, if a party in interest objects.

Section 502(b), however, throws a wrench into this interpretation of § 502(a). Section 502(b) says that if "such an objection" is filed, the court "shall" allow the claim except to the extent it can be disallowed under paragraphs (1) through (8) of

§502(b). Paragraphs (1) through (8) of § 502(b) do not include

late filing of the proof of claim as a ground for disallowing a claim.

The words "such an objection" could be taken as a reference to the eight grounds for disallowance set out in § 502(b). This would leave failure to file in accordance with the rules as an independent ground under §502(a) for objecting and for disallowing the claim.

On the other hand, "such an objection" in § 502(b) can be taken as a reference to any kind of objection. Section 502(b) would in effect say:

If a party in interest objects to a claim on any ground, the court can disallow the claim only under § 502(b)(1)-(8); any other type of objection, including an objection under § 502(a) for failure to file the proof of claim in accordance with the rules, cannot result in disallowance.

Under this interpretation, § 502(b) recognizes other grounds for objecting, such as late filing, but they are not grounds for disallowing the claim. This result makes sense if the statutes provide a penalty other than disallowance for the other kinds of objections.

This brings up § 726(a)(3). It supposedly creates a penalty other than disallowance for late-filed claims. Section 726 applies only in chapter 7 liquidation cases. 11 U.S.C. §103(b). A late filed claim may be allowed as timely filed if the creditor did not receive adequate notice. Section 726(a)(3) deals with late-filed claims that cannot be treated as timely filed.

11 U.S.C. § 726(a)(2)(C) & (a)(3). These late-filed claims can be paid only if there is a surplus after paying administrative expenses and timely filed claims. 11 U.S.C.A § 726(a)(3).

Section 1325(a)(4) supposedly incorporates this rule into Chapter 13. Section 1325(a)(4) provides that a plan can be confirmed if each allowed unsecured claim will be paid not less than the amount that would be paid on the claim in a chapter 7 liquidation as of the effective date of the plan. The argument is that § 726 applies under § 1325(a)(4) to determine what would be paid on late-filed unsecured claims in a chapter 7 liquidation. 11 U.S.C. 1325(a)(4); *see also* §§ 1129(a)(7)(A)(ii) & 1225(a)(4).³

This argument raises a question regarding any objection under the rules other than late filing. Suppose the bankruptcy trustee objects because the creditor did not attach documents as required by Rule 3001(c). FED. R. BANKR. P. 3001(c). If "such an objection" in § 502(b) means any objection, then the court cannot disallow the claim on this ground. Indeed, § 502(b) seems to say that the court must allow the claim.

If the court cannot disallow the claim, what is the penalty? Section 726 supposedly creates a penalty other than disallowance when late filing is the problem, but the statutes do not set out a different penalty for other objections based on the rules. This implies at least three possible results.

³ The court is using unsecured claims to mean general or non-priority unsecured claims, since priority claims must be paid in full. 11 U.S.C. §§ 1322(a)(2) & 1325(a)(1).

First, the court can disallow the claim only if it holds that the defect prevents the filed proof of claim from being "proof of the claim under § 501." The court has already rejected this argument, but it may be a better result than the second possible result.

Second, failure to file the proof of claim in accordance with the rules is not a ground for disallowing the claim, but the court can create some penalty other than disallowance. This result suffers from the same problem as the first. It would make the administration of bankruptcy cases inefficient by introducing too much uncertainty and lack of uniformity.

Third, the argument under § 726 and § 1325 assumes a general rule that a claim can be disallowed if the proof of claim does not meet the requirements set by the rules. However, the general rule does not apply with regard to late filing. Late filing is not a ground for disallowing a claim because § 726 provides a different penalty in both chapter 7 cases and chapter 13 cases.

The third possibility seems to be the narrowest and most persuasive argument for a rule that late filing is not a ground for disallowing a claim in a chapter 13 case. The court disagrees, however, on the ground that it relies on a misunderstanding of § 502 and § 726.

The court thinks that § 502(b) deals with objections under § 502(b)(1)-(8). The words "such an objection" refer to the objections listed in §502(b). When an interested party files an objection under § 502(b), the court must allow the claim to the

extent it cannot be disallowed under § 502(b)(1)-(8). This roundabout wording recognizes that an objection prevents a claim from being deemed allowed.⁴ If any part of the claim is to be allowed after the ruling on the objection, the court must specifically allow it. Section 502(b) does not mean that a claim must be allowed despite an objection under the rules and § 502(a).

The other interpretation of § 502(b) also suggests a procedure that is not correct. If an interested party objected under the rules and § 502(a), the court would be required on its own initiative to consider the grounds for disallowance under § 502(b).

In summary, failure to file a proof of claim in the manner required by the rules is a ground for not allowing or disallowing a claim, if a party in interest objects. The grounds set out in § 502(b) are not the only grounds for disallowing a claim. See *generally* Hon. Kathleen P. March & Rigoberto V. Obregon, *Objecting to Claims: The Downfall of Five Great Bankruptcy Myths*, 18 CALIF. BANKR. L. J. 299 (1990).

There may be a fundamental difference between objections under the rules and objections under § 502(b), and as a result, there may be two different kinds of disallowance. But this is just a shorthand method of saying that the after-effects of an objection

⁴ This means that "objects" in § 502(a) refers to objections under either the rules and § 502(a) or § 502(b). Either kind of objection prevents a claim from being disallowed. On the other hand, "such and objection" in § 502(b) does not refer to objections under the rules and § 502(a).

and disallowance will vary according to the basis of the objection.⁵ Hon. Kathleen P. March & Rigoberto V. Obregon, *Objecting to Claims: The Downfall of Five Great Bankruptcy Myths*, 18 CALIF. BANKR. L. J. 299 (1990). The courts can deal with this problem without using a different word, such as "unallowance," instead of disallowance.

Thus, §§ 501 and 502 create a general rule that the court can disallow a claim for failure to file the proof of claim in accordance with the rules. This means that, as a general rule, late filing is a ground for disallowing a claim.

Section 726(a)(3) does not deal with allowance or disallowance of late-filed claims. It says that "allowed" late-filed claims can be paid after full payment of timely filed claims. 11 U.S.C. § 726(a)(3). The *Hausladen* case and its followers read this to mean that late-filed claims must be allowed or cannot be disallowed on the ground of late filing. This is a misunderstanding of how § 726(a)(3) works.

A chapter 7 trustee need not object to late-filed claims if there is no money to pay on unsecured claims. It will make no difference that they are deemed allowed. If the chapter 7 trustee has money to pay on unsecured claims, the trustee will object to the late-filed claims. The objection is necessary for two reasons.

First, it breaks the unsecured claims into a timely filed class and a late-filed class so that the late-filed claims can be

⁵ See footnote 2.

subordinated to full payment of the timely filed claims.

Second, the objection may bar a creditor with a late-filed claim from coming in *after the trustee has made a distribution on the timely filed claims* and proving that, due to inadequate notice of the bankruptcy, its claim should be treated as timely filed. The objection invites a creditor to respond with the inadequate-notice argument or lose the argument permanently under the doctrine of *res judicata*.

When the chapter 7 trustee objects to late-filed claims, the court may enter an order allowing the late-filed claims against the surplus, if any, after full payment of the timely filed and allowed claims. This is not the same thing as the normal allowance under §§ 501 and 502. It has the same effect as disallowance if there will be no surplus. Indeed, the court may simply disallow the late-filed claims on the ground that they were filed late, and there will not be any surplus to pay on them.⁶

Even in a chapter 7 case, § 726 does not mean that late-filed claims must be allowed in the normal sense and cannot be disallowed on the ground of late filing. It only provides a fail-safe procedure that prevents money from going back to the debtor as a result of the failure by the creditors to file their claims before the deadline. 3 JAMES W. MOORE, ET AL., COLLIER ON BANKRUPTCY ¶ 57.33 (14th ed. 1978); 4 LAWRENCE P. KING, ET AL., COLLIER ON BANKRUPTCY

⁶ It may be more efficient to allow the late-filed claims against a surplus, if any. The court may avoid a motion and hearing later if the trustee unexpectedly ends up with a surplus.

¶ 726.02[3] (15th ed. 1994).

Section 726 agrees with and implies a general rule that late filing is a ground for disallowing a claim. The *Hausladen* line of cases rejects this reasoning because the current statutes do not expressly make late filing a ground for disallowing a claim, whereas the prior statutes specifically said that it was. 3 JAMES W. MOORE, ET AL., COLLIER ON BANKRUPTCY ¶ 57.26 (14th ed. 1978). The court has already disagreed with the basis of this argument. Sections 501 and 502 create a general rule that late filing is a ground for disallowance.

Furthermore, the prior law had the same effect. It said that late filing was a ground for not allowing a claim, but it provided that late-filed claims could be paid in a liquidation case from a surplus after full payment of timely filed claims. 3 JAMES W. MOORE, ET AL., COLLIER ON BANKRUPTCY ¶ 57.26 & ¶ 57.33 (14th ed. 1978).

The court's reasoning leads to the conclusion that the chapter 7 procedure for dealing with late-filed claims is not carried over to chapter 13 by § 1325(a)(4). In chapter 13 cases the general rule applies. Late filing is a ground for disallowing the claim. The plan need not provide for payment of late-filed claims, and the court need not be concerned with whether there would be any payment on the late-filed claim in a chapter 7 liquidation. Section 726(a)(3) is irrelevant.

Courts have cited other statutes to support the theory

that late filing is not a ground for disallowance. The court will deal with these arguments shortly.

Section 506(d) provides that a creditor's lien on property of the bankruptcy estate is void to the extent the claim is not allowed as secured. This voids the lien to the extent the secured debt exceeds the value of the bankruptcy estate's interest in the property. 11 U.S.C. § 506(a),(d).

Section 506(d)(2) creates an exception. If the only reason the claim is not allowed as secured is "the failure of any entity to file proof of such claim under section 501", then the lien is not voided. 11 U.S.C. § 506(d).

The argument assumes that says that "failure . . . to file proof of such claim" means failure to file anything. Under this assumption, the lien is *not* voided if the creditor failed to file anything, but the lien is voided if the creditor files a proof of claim but the claim is disallowed because the proof of claim did not comply with the rules.

The court disagrees. Failure to file proof of the claim should mean the same thing in § 506(d)(2) as in § 502(a). It also means failure to file proof of the claim in accordance with the rules. Thus, the exception applies and prevents the lien from being avoided when the only reason for not allowing the claim as secured is late filing of the proof of claim.

Subsections (b) and (c) of § 501 have also been used to support the *Hausladen* result. Subsections (b) and (c) allow a co-debtor, the bankruptcy trustee, or the debtor to file a proof of

claim on behalf of a creditor if the creditor does not file a *timely* proof of claim. 11 U.S.C. § 501.

The rules follow the implied authority given by § 501. They set a bar date for creditors and a later bar date for the debtor, the trustee, or a co-debtor to file a proof of claim on behalf of a creditor who misses its bar date. FED. R. BANKR. PROC. 3002-3005. If the debtor, a co-debtor, or the bankruptcy trustee files a proof of claim for the creditor before the later bar date, then the creditor's claim is timely filed. Subsections (b) and (c) of § 501 deal with timely filed claims. They are irrelevant to the question of whether late filing is a ground for disallowing a claim.

The court should also point out that the Supreme Court in the *Pioneer Investment* case assumed that late filing was a ground for disallowing a claim in a chapter 11 case. *Pioneer Investment Services Co. v. Brunswick Associates Ltd. Partnership*, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993).

There are other logical and practical problems with the arguments in support of the *Hausladen* result. See, e.g., *Gullatt v. United States (In re Gullatt)*, No. 3:94-0229, 1994 WL 371077 (M. D. Tenn. Jul. 7, 1994)(Wiseman, D.J.) *rev'g In re Gullatt*, 164 B.R. 279 (Bankr. M. D. Tenn. 1994); *In re Zimmerman*, 156 B.R. 192, 24 Bankr.Ct.Dec. 759, 29 Collier Bankr.Cas.2d 370 (Bankr. W. D. Mich. 1993); *In re Johnson*, 156 B.R. 557, 29 Collier Bankr.Cas.2d 425 (Bankr. N. D. Ill. 1993).

This memorandum is the court's findings of fact and conclusions of law. FED. R. BANKR. P. 7052. The court will enter an order.

At Chattanooga, Tennessee

BY THE COURT

R. Thomas Stinnett
U. S. Bankruptcy Judge

[entered 12/5/94]